Supreme Court, U.S.
FILED
JAN 27 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-826

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

JEROME F. GOLDBERG AND ROBERT MCTIGUE,
Appellants,

v.

ROGER D. SWEET, DIRECTOR OF THE ILLINOIS DEPARTMENT OF REVENUE, *et al.*,
Appellees.

On Appeal from the Supreme Court of Illinois

BRIEF OF THE NATIONAL TAXPAYERS UNION AS AMICUS CURIAE IN SUPPORT OF APPELLANTS

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Having obtained the written consent of the parties pursuant to Rule 36.1 of the Rules of this Court,[1] the National Taxpayers Union submits this brief as amicus curiae, and respectfully suggests that this Court note probable jurisdiction and reverse the decision below.

INTEREST OF THE NATIONAL TAXPAYERS UNION

The National Taxpayers Union ("NTU") is a non-profit, membership organization devoted to protecting the interests of federal, state, and local taxpayers through

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[1] Copies of the consent letters have been filed with the clerk.

public education, lobbying and litigation on tax and spending issues. NTU's nearly 150,000 members have a direct economic interest in this action. First, as Illinois citizens and taxpayers, many NTU members are directly and adversely affected by the Illinois telephone tax. Second, if this Court fails to hear this appeal, thereby effectively deciding it against Appellants, NTU members throughout the United States may soon be subjected to similar taxes in their own jurisdictions.[2]

SUMMARY OF ARGUMENT

Since at least *Gibbons* v. *Ogden*, 9 Wheat. 1 (1824), and *Brown* v. *Maryland*, 12 Wheat. 419 (1827), this Court's vigorous enforcement of the Commerce Clause has guaranteed that the United States would remain, economically, one nation. State governments have repeatedly invented ingenious schemes for taxing commerce with non-residents more heavily than similar commerce involving residents, and this Court has just as repeatedly struck down all such schemes. See, most recently, *American Trucking Associations, Inc. v. Scheiner*, 107 S. Ct. 2829 (1987). The benefits to the nation of the Court's steadfastness on this issue have been incalculably great.[3]

This case involves another such scheme—a tax which seems plausibly even-handed on first reading, but which upon even cursory analysis shows itself to be highly dis-

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[2] Numerous states, and even municipalities, have now begun to tax interstate telecommunications, as noted in the opinion below and the Jurisdictional Statement (at 25 n.20 & 27 n.24).

[3] Similar barriers erected by the various states under the Articles of Confederation precipitated the Constitutional Convention. "The very purpose of the Commerce Clause was to create an area of free trade among the several states." *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944). The Supreme Court has a particular responsibility to carefully review state tax laws, which, owing to the Tax Injunction Act, 28 U.S.C. 1341, are unlikely to receive judicial scrutiny in any other federal forum.

criminatory against interstate commerce. For commercial activities carried out by telephone (and other forms of telecommunications as well), the tax systematically raises the relative cost of interstate as opposed to intrastate transactions, and awards Illinois business an unwarranted advantage in competing for Illinois trade. Ironically, this latest attempt at balkanizing the nation is aimed at precisely that sector of the economy which has increasingly become the irreplaceable electronic link among all Americans—the telecommunications industry.

ARGUMENT

I. The Nature and Incidence of the Tax Varies with the Type of Charge It Is Applied Against

The Telecommunications Excise Tax Act, Ill. Rev. Stat. ch. 120, para. 2001-2021, imposes a tax (the "telephone tax") "upon the act or privilege of originating in this State or receiving in this State" interstate and intrastate telecommunications. Secs. 2002-2004. The tax is imposed at the rate of 5% of the "gross charge" for telecommunications purchased at retail in Illinois and billed to an Illinois address. *Id.* "Gross charge" is defined as "the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services . . . provided therewith . . .", excluding, *inter alia*, charges for customer equipment (whether purchased, leased, or rented) when such charges are "separately identified from other charges." Sec. 2002(a).

The tax reaches both "intrastate" and "interstate" telecommunications. Secs. 2003-2004. The statute defines "interstate telecommunications" as "all telecommunications that either originate or terminate outside this State." Sec. 2002(d). Thus, the Act taxes long distance charges for both domestic and overseas calls.

From the consumer's perspective, the tax is imposed on three items: the basic monthly charge for telephone

service; any long distance charges; and any message unit charges incurred for local calls beyond those which are provided as a part of basic service. The economic effect of the tax differs in each case.

The basic service charge is a payment made for the right to access the telephone network. In the telecommunications industry, it is frequently referred to as a charge for "dial tone." In Illinois, as in much of the nation, one can purchase several types of basic service. These range from "unlimited" local service, which includes the right to make an unlimited number of free calls within a local calling area; to various budget plans, under which the consumer is entitled to a fixed number of local calls, with additional calls being subject to a small message unit charge; to "measured zero" service, under which the customer incurs a message unit charge on every local call.[4] Even in places that do not offer unlimited free calling throughout the local calling area, local calls within a fixed geographic radius of the caller's telephone typically carry only one message unit, regardless of duration.[5]

Under any of these plans, the charge for basic telephone service is a fixed monthly charge, and the percentage tax imposed on it has the character of a "lump sum" tax. For example, a consumer with "unlimited" local service may make no local calls in a given month, or a thousand local calls. In either case, he pays the same amount of tax. His tax rate, at the margin, is zero. Thus, while the tax may cause some low income consumers to forego telephone service entirely, it will have no effect at all on the local calling patterns of con-

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[4] Not all areas have all three types of plan. For example, residential subscribers in Peoria have a choice between "measured zero" and unlimited service within their local calling area.

[5] In the Chicago area, for example, this local radius is eight miles.

sumers who retain unlimited service. Nor, so long as they remain below their monthly allowance, will it have any effect on the local calling patterns of individuals with "budget" type service.[6]

On the long distance portion of the bill, the consumer is charged for use of the long distance network. Charges vary as a function of the number of calls made, the locations called, call duration, and the time of day. Thus, as applied to long distance calls, the telephone tax is a true excise tax, in that it systematically increases the price of the item taxed by a fixed percentage. In so doing, it necessarily tends to inhibit consumption of that item—in this case, long distance service.

As applied to message unit charges, the telephone tax in question here shows aspects of both a lump sum and an excise tax. It is a lump sum tax to the extent that it frequently does not vary with the duration of the call, or the location called;[7] it is an excise tax because it does vary with the number of calls made each month by an individual consumer over and above his basic allotment. Moreover, the amount involved per call (five cents per message unit in Chicago, for example) is typically very small by comparison with long distance charges for calls of the same length.

Most intrastate telephone calls in Illinois are local, and many, if not most, local calls carry either a single message unit or no message unit charge. On the other hand, nearly all interstate calls from Illinois are long distance.[8]

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[6] For a more extended discussion of the differences between lump sum taxes and true excise taxes in their effect on consumer behavior, see Koch, *Microeconomic Theory and Application*, at 238-239 (Little, Brown & Co. 1976).

[7] This is the case, for example, for calls made in the Chicago area to points within approximately an eight mile radius of the caller's telephone.

[8] A small number of interstate calls, *e.g.*, those from Moline to Davenport, are within a local calling area.

In these circumstances, a tax imposed as a flat percentage of all local and long distance telephone charges will systematically raise the marginal cost of making interstate telephone calls without having the same impact on intrastate calls.

II. The Telephone Tax Discriminates Against Interstate Commerce

"No State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'" *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977). To decide the issue of discrimination, this Court looks to the practical economic effects of a tax. not to the mere form of words used in the statute. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). The validity of a tax will not be saved by showing that it might be constitutional under particular economic, geographic, or political conditions. A tax will be struck down if it is discriminatory, either on its face or as applied, under any reasonably conceivable circumstances. *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984). Under these standards, and as applied to the various types of charges described above, the Illinois telephone tax is blatantly discriminatory against interstate communication.

A concrete example will demonstrate this fact. Consider two businesses, one located in Waukegan, Illinois and the other in Gary, Indiana: both businesses send catalogues to consumers in Chicago, and encourage those consumers to call in their orders by telephone. A five minute call to Waukegan (over a distance of about forty miles) costs a Chicago consumer (day rates, station to station) 26 cents, and incurs a telephone tax of 1.3 cents. A call to Gary from the same consumer (over a distance of about twenty miles) incurs a charge of $1.42 and a telephone tax of seven cents. The telephone tax penalizes

the Gary catalogue business, and benefits the Waukegan business—precisely the result prohibited by the Commerce Clause. In fact, the tax paid on the call to Gary is more than five times as great as the tax on the call to Waukegan. Moreover, the telephone tax does not have a compensating reverse effect when Gary consumers are substituted in this illustration for Chicago consumers. In that reverse case, neither call bears any tax.

In *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 395 n.9 (1984), this Court used "[h]ypothetical examples [to] demonstrate that similarly situated corporations . . . would face different tax assessments in New York depending on the location from which [each] shipped its exports." The Court noted that this tax scheme "not only . . . 'provide[d] a positive incentive for increased business activity in New York State' . . . but also . . . penalize[d] increases in . . . shipping activities in other states." *Id.* at 395-396. Similarly, in this case, the telephone tax penalizes out-of-state businesses that wish to increase their sales or customer relations activities in Illinois by making access to those businesses more costly for Illinois consumers.

The Illinois telephone tax is essentially a tax on the privilege of communicating with people outside the State of Illinois, structured so as to reduce the demand for such communications, yet having little or no effect on the demand for intrastate communications.[9] It would be

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[9] Since Illinois is a large state, the tax on a small minority of intrastate calls (for example from Chicago to Cairo) may approximate that on interstate telephone communications over equal or greater distances. But these are the exceptions, not the rule. The vast majority of intrastate calls are local free or message unit calls, or calls like that from Chicago to Waukegan which bear very low charges. Moreover, if the Illinois tax is approved by this Court, whether by plenary action or through a summary affirmance, identical taxes in other, smaller states will be immune from constitutional challenge. *Hicks v. Miranda*, 422 U.S. 332 (1975). Thus,

hard to conceive of a more effective deterrent to interstate commerce, or a more powerful incentive for the members of a single state or locality to deal solely with each other.

This discriminatory effect cannot be justified by the fact that the dollar amounts at stake on each individual transaction are small, or by the argument that Illinois consumers would be more likely to interact with Illinois businesses in any event. This Court rejected these precise arguments in *Boston Stock Exchange, supra,* at 334 n.13. "Even if we did not conclude that . . . sellers are likely to rely on economic rather than geographical factors in choosing an exchange, [the challenged tax] would fall before the Commerce Clause. . . . [T]he Clause protects out-of-state businesses from *any* discriminatory burden on their interstate commercial activities." Emphasis added.

The Illinois telephone tax discriminates against interstate commerce, and must be struck down.

III. The Telephone Tax Is Unapportioned, and Is Not Fairly Related to Services Provided by Illinois

While the persuasive arguments made by Appellants on these points (Jurisdictional Statement, at 11-20, 23-25) need no extensive support, it may be helpful to consider the following brief example: [10]

> • A half hour call from Chicago to East St. Louis, Illinois originates with an Illinois telephone, is handled by an Illinois local operating company, an Illinois long distance company, and a second Illi-

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even states like Rhode Island, where most of the population can make unlimited free calls to nearly the entire state, could adopt with impunity a tax modeled on the Illinois statute.

[10] All charges are day rate, station to station, AT&T.

nois local operating company, and ultimately reaches an Illinois called party. In each of these five stages, this intrastate call involves persons and facilities enjoying the protections and benefits of Illinois law. This call costs $7.64, plus a telephone tax of 38 cents.

- A half hour call from Chicago to Honolulu originates with an Illinois telephone, is handled by an Illinois local operating company and long distance company, then is transferred to an out of state long distance company and a Hawaiian local operating company before it finally reaches a called party in Hawaii. This call uses far *fewer* facilities having contact with Illinois than the call to East St. Louis. Yet this call bears a *higher* telephone tax of 56 cents, on a charge of $11.19.

- A half hour call from Chicago to Bangkok, Thailand passes through the same Illinois equipment as the call to Honolulu, and like that call uses fewer in-state facilities than the call to East St. Louis. But the call to Bangkok uses a huge amount of additional telephone equipment located outside both Illinois and the United States. The cost of these extensive international facilities drives the price of such a call up to $35.46, plus a telephone tax of $1.77.

In short, as Appellants point out (Jurisdictional Statement at 23) the telephone tax imposes a higher *amount* of tax on activities with *fewer* in-state contacts. The value of services provided within Illinois is substantially less in the case of the calls to Honolulu and Bangkok than in the case of the call to East St. Louis, but the tax imposed is higher.

But even if one assumes (contrary to fact) that the value of the Illinois services involved in each of these calls is *the same*, the tax rate imposed is still higher when the call is made to a place outside Illinois. For example, the tax on the call to East St. Louis constitutes only *5 percent* of the charge attributable to use of the

Illinois facilities actually involved in that call; by contrast, the telephone tax on the call to Honolulu constitutes *7.3 percent* of the same $7.64 charge, while the tax imposed on the call to Bangkok constitutes *23 percent* of that same charge. In *Scheiner* this Court held that, "when the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may properly conclude . . . that the State is imposing an undue burden on interstate commerce." 107 S.Ct. at 2844. This is clearly the case with the telephone tax.

Electronic telecommunications are the messengers of modern times. If Illinois attempted to tax United Parcel Service on the entire value of its services for all packages picked up in the state, regardless of where they were delivered, that tax would fall before the Commerce Clause. *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). Yet telecommunications companies, whether they are in the telephone, telegraph, or electronic data transmission business, provide a service which, for many purposes, is functionally identical. A tax on these services that is unallocated and not fairly related to services provided by the state is equally invalid.

CONCLUSION

For the foregoing reasons, and for the reasons set forth in the Jurisdictional Statement, this Court should note probable jurisdiction and reverse the decision below.

Respectfully submitted,

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